

IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

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IN RE:

REVIEW OF NASHVILLE GAS
COMPANY'S IPA RELATING TO ASSET
MANAGEMENT FEES

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T.R.A. DOCKET ROOM

DOCKET NO. 05-00165

**SECOND REQUESTS FOR ADMISSION TO NASHVILLE GAS COMPANY
BY THE CONSUMER ADVOCATE AND PROTECTION DIVISION**

To: Nashville Gas Company
c/o James H. Jeffries IV, Esq.
Moore & Van Allen
100 North Tryon Street, Suite 4700
Charlotte, North Carolina 28202-4003

c/o R. Dale Grimes, Esq.
Bass, Berry & Sims, PLC
2700 First American Center
Nashville, Tennessee 37238-2700

These Requests for Admission are hereby served upon Nashville Gas Company, a Division of Piedmont Natural Gas Company, Inc. ("Nashville Gas", "Piedmont" or "Company"), pursuant to Rule 36 of the Tennessee Rules of Civil Procedure. We request that full and complete responses be provided pursuant to the Tennessee Rules of Civil Procedure. The responses are to be produced at the Office of the Tennessee Attorney General and Reporter, Consumer Advocate and Protection Division, 425 Fifth Avenue North, Nashville, Tennessee 37243, c/o Joe Shirley or Steve Butler, on or before January 20, 2006

DEFINITIONS

For purposes of these Requests for Admission, the term “you” shall mean and include: Nashville Gas Company, Piedmont Natural Gas Company, Inc. and all employees, agents and representatives thereof.

INSTRUCTIONS

(1) If your response to any Request for Admission is other than an unqualified admission, state for each such Request for Admission the following:

(a) all facts that you contend support in any manner your refusal to admit or your qualification of your admission;

(b) the name and address of all persons, including, but not limited to, consultants purporting to have any knowledge or factual data upon which you base your refusal to admit or your qualification of your admission;

(c) the identity of all documents, or any tangible or intangible thing, that supports in any manner your lack of admission or your qualification of your admission;

(d) the name and address of the custodian of all documents and tangible things identified in response to subsection (c); and

(e) the correct information for any Request for Admission that you contend is incorrect or inaccurate.

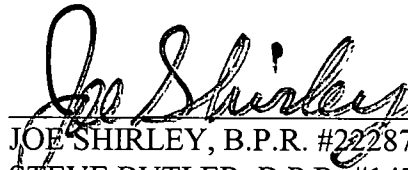
(2) If you fail to admit or deny any Request for Admission based on your asserted lack of information or knowledge, for each such Request for Admission describe your efforts toward satisfying the reasonable inquiry requirement of Rule 36 of the Tennessee Rules of Civil Procedure.

REQUESTS FOR ADMISSIONS

1. Please admit the genuineness of the document attached to this request, which is entitled "Initial Comments and Proposed Framework of Piedmont Natural Gas Company, Inc. and UGI Utilities, Inc. Regarding the Interstate Natural Gas Transportation Market."

RESPONSE:

RESPECTFULLY SUBMITTED,

A handwritten signature in black ink, appearing to read "Joe Shirley", is written over a horizontal line.

JOE SHIRLEY, B.P.R. #22287

STEVE BUTLER, B P.R. #14772

Assistant Attorneys General

Office of the Attorney General

Consumer Advocate and Protection Division

P.O. Box 20207

Nashville, Tennessee 37202

(615) 741-3549

Dated: January 3, 2006

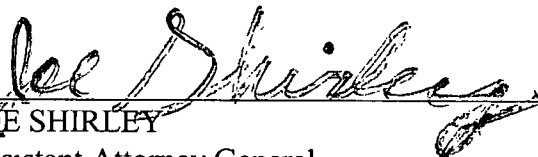
CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing has been served via hand delivery or first-class U.S. mail, postage prepaid, on this 3rd day of January, 2006, upon:

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FEDERAL ENERGY
REGULATORY COMMISSION

April 21, 1999

VIA FEDERAL EXPRESS

Ms. Lois Cashell
Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, D.C. 20426

Re: *Regulation of Short-Term Natural Gas Transportation Services*
Docket No. RM98-10-000
Regulation of Interstate Natural Gas Transportation Services
Docket No. RM98-12-000

Dear Ms. Cashell:

I have enclosed an original and 15 copies of each of the following:

1. *The Initial Comments and Proposed Framework of Piedmont Natural Gas Company, Inc. and UGI Utilities, Inc. Regarding the Interstate Natural Gas Transportation Market; and*
2. *The Initial Comments of North Carolina Natural Gas Corporation.*

Please accept the original and 14 copies of each of the enclosed for filing, file stamp the additional copies and return them to me in the enclosed, self-addressed stamped envelope.

Pursuant to the Commission's *Notice of Proposed Rulemaking* issued in Docket No. RM98-10-000, both of the enclosed comments were also submitted electronically.

Thank you for your assistance.

Sincerely,



Sonya R. Lowe
Legal Assistant

srl

Enclosures

990422-0132-2

FERC DOCKETED

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OFFICE OF THE SECRETARY

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C.

FEDERAL ENERGY
REGULATORY COMMISSION

Regulation of Short-Term Natural
Gas Transportation Services

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Docket No. RM98-10-000

Regulation of Interstate Natural
Gas Transportation Services

Docket No. RM98-12-000

**INITIAL COMMENTS AND PROPOSED FRAMEWORK OF
PIEDMONT NATURAL GAS COMPANY, INC. AND UGI UTILITIES, INC.
REGARDING THE INTERSTATE NATURAL GAS
TRANSPORTATION MARKET**

Piedmont Natural Gas Company, Inc. ("Piedmont") and UGI Utilities, Inc. ("UGI"), through counsel and pursuant to the *Order Granting Extension Of Time For Filing Comments* issued by the Federal Energy Regulatory Commission ("FERC" or the "Commission") on December 23, 1998 in the above-captioned dockets, respectfully submit the following initial comments and proposed framework for the future regulation of the interstate natural gas transportation market ("Comments").¹ Piedmont and UGI's Comments are intended to address both the Commission's *Notice of Proposed Rulemaking* issued in Docket No. RM98-10-000 ("NOPR") as well as the Commission's *Notice of Inquiry* in Docket No. RM98-12-000 ("NOI"). Piedmont and UGI's purpose in filing these Comments is to present an overarching model and

¹UGI is a local natural gas distribution company ("LDC") which serves approximately 260,000 residential, commercial and industrial customers in 14 counties in central and eastern Pennsylvania, a state in which "customer choice" is offered by some LDCs but not mandated for the state as a whole. While yet to voluntarily offer "customer choice" to its small volume residential customers, UGI currently provides transportation (or delivery) service for more than 1,200 commercial and industrial customers comprising approximately 65 percent of annual throughput. UGI's retail sales and transportation rates are competitively designed to attract new, and retain current customers and allow it to earn a reasonable rate of return while, at the same time, providing safe and reliable service at a reasonable cost. Where natural gas service is available, UGI's share of new residential heating load exceeds 90 percent.

While joining Piedmont in these comments, UGI is also filing comments as an individual company and as a member of the AGA addressing other related issues presented by the NOPR and the NOI.

supporting discussion of how interstate natural gas transportation service should be regulated in the future. These Comments are filed in both the NOPR and NOI proceedings because Piedmont and UGI's recommendations encompass both primary² and secondary³ markets for pipeline capacity on both a long and short-term basis.⁴ In Piedmont and UGI's view, the various markets for interstate natural gas transportation capacity are integrally linked and must be examined together if a workable regulatory scheme for the interstate natural gas market as a whole is to result from these proceedings.

As is discussed in greater detail below, Piedmont and UGI have been active participants in the proceedings in these dockets and in the substantial industry discussions sponsored by the Natural Gas Council directed at identifying and exploring issues raised by the Commission's NOPR and NOI.⁵ Piedmont and UGI believe that many of the concepts set forth below balance the interests and concerns expressed by parties in every sector of the industry and that their proposed framework is a fair and achievable approach to restructuring the interstate natural gas transportation market. Piedmont and UGI also believe that their proposal

²For purposes of these Comments, the primary market refers to any transportation service provided directly by an interstate natural gas pipeline and specifically includes all firm and interruptible services.

³The secondary market refers to rebundled commodity sales and the release of capacity by shippers who hold firm capacity on interstate natural gas pipelines.

⁴Long term refers to service arrangements of one year or longer. Short term refers to service arrangements of less than a year.

⁵Piedmont's Senior Vice President of Gas Supply and Services is one of six local distribution company ("LDC") representatives serving on the Natural Gas Council dialogue group. In addition to LDCs, the group is comprised of major independent producers, interstate pipelines, an independent gas marketer, gas municipalities, and power generation and industrial gas consumers.

appropriately balances regulatory concerns with the need for more competitive, creative and dynamic markets as the natural gas industry enters the 21st Century.

EXECUTIVE SUMMARY

In these Initial Comments, Piedmont and UGI propose a model for the restructuring of the primary and secondary natural gas transportation markets in order to facilitate growth and competition in these developing markets. Piedmont and UGI's submission of this model is based on their conclusion that the mechanisms set forth in FERC's NOPR will not solve problems inherent in those markets today and will impede the efficient operation of the interstate natural gas transportation markets in the United States in the future. Piedmont and UGI believe that their model is balanced, addresses the primary inefficiencies in the existing markets as well as the principal concerns raised by various sectors of the industry and the Commission in the discussions that have followed issuance of FERC's NOPR and NOI.

Commission regulation of the primary and secondary interstate natural gas transportation markets which resulted from Order 636 was focused on preventing market power abuse and ensuring the availability of natural gas pipeline transportation services on a non-discriminatory basis. As a result, the Commission created a highly regulated and restrictive operating environment for the negotiation and completion of natural gas transportation transactions. Since Order 636, however, the primary and secondary markets for interstate pipeline capacity have become subject to more dynamic and market driven forces. This has resulted both from the creative and competitive efforts of industry participants as well as developing FERC policies which have adopted a more market based approach to regulating interstate natural gas transportation.

Some FERC policies and regulations adopted in the Order 636 proceedings, however, continue to impede the efficient and economic operation and development of these markets.

Several of the major problems associated with FERC's existing regulation of the primary and secondary markets include: (1) a significant price and risk misalignment between long-term and short-term transportation services in both the primary and secondary markets; (2) substantial risks to long-term capacity holders arising from this price/risk misalignment and the Commission's continued use of SFV rates for interstate natural gas pipelines; and (3) unnecessarily restrictive capacity release regulations which inhibit competition in the secondary market.

While Piedmont and UGI acknowledge FERC's effort to address some of the inefficiencies and problems inherent in its existing regulations, Piedmont and UGI do not believe that the mandatory auction and short-term market deregulation approach adopted by FERC in its NOPR is workable or likely to lead to desirable results. Piedmont and UGI perceive several specific problems in FERC's proposals. First, the mandatory auction approach to regulating short-term capacity transactions is not capable of curbing market power (it will only serve to help identify it), is enormously complex to design (and may be impossible to implement) and creates significant procedural impediments to a dynamic short-term capacity market. Second, deregulating pipeline short-term services will increase the likelihood of market power abuse because of the intrinsic ability of pipelines to "create" capacity that is unavailable to other shippers and the superior market knowledge of pipelines. Third, the elimination of reserve pricing for pipeline services will result in excessive volatility in the market for short-term services, because in periods of low demand, services will be driven down to incremental cost which will, in turn, provide incentive for pipelines to artificially constrain capacity in periods of peak demand in order to recover revenues lost during off-peak periods. In light of these problems, Piedmont and UGI believe a different approach to restructuring regulation of the primary and secondary markets is needed.

Piedmont and UGI have formulated their own proposal for the restructuring of the primary and secondary markets which addresses the primary concerns raised by most segments of the industry regarding those markets and avoids the pitfalls inherent in FERC's approach. The fundamental attributes of Piedmont and UGI's proposed framework for restructuring the natural gas primary and secondary transportation markets are as follows:

- (1) Preservation of high quality, cost-based long-term pipeline recourse service subject to a mandatory departure from SFV rate design;
- (2) Increased pipeline flexibility to negotiate terms and conditions of service with appropriate safeguards;
- (3) Optional pricing flexibility for (but not deregulation of) primary pipeline short-term services combined with implementation of a revenue crediting mechanism; and
- (4) Deregulation of secondary capacity release transactions.

High quality cost-based recourse service is, and should remain, the touchstone for interstate natural gas pipeline capacity. However, in order to reduce the risk of holding this capacity and to correct the price/risk misalignment between long-term and short-term capacity, SFV rates should be abandoned. Pipeline ability to compete and expand service offerings should be facilitated through the ability to negotiate terms and conditions of service, with appropriate safeguards, and to "flex up" pricing for short-term services to respond to market conditions with an appropriate revenue crediting mechanism to curb pipeline over-recoveries. Finally, because of existing competition and the lack of market power concerns (assuming pipeline short-term service is not deregulated) secondary capacity release transactions should be fully deregulated in order to make capacity release comparable to rebundled commodity "basis" sales.

Adoption of Piedmont and UGI's proposal will have substantial benefits to all participants in the interstate natural gas markets. These benefits include: (1) the continuing

availability of high quality recourse service at cost-based rates; (2) a deregulated, flexible and competitive secondary market; (3) increased service and pricing flexibility for interstate pipelines; (4) no need to examine market power issues; (5) increased market liquidity for and commoditization of capacity transactions; (6) proper price and risk relationships between long and short-term services; and (7) more efficient utilization of interstate pipeline capacity.

COMMENTS AND PROPOSED FRAMEWORK

I. BACKGROUND ON PIEDMONT

Piedmont is the second largest LDC in the Southeast, headquartered in Charlotte, North Carolina, providing natural gas sales and transportation service to more than 625,000 residential, commercial, industrial and power generation customers in the states of North Carolina, South Carolina and Tennessee. Piedmont serves one of the fastest growing markets in the nation for natural gas usage and in recent years has expanded its customer base at more than three times the national average. This market growth has occurred primarily in the residential and small commercial sectors, and Piedmont expects this to remain true into the future even while the market for gas-fired power generation in the Southeast expands.

To serve its natural gas customers, Piedmont subscribes to and manages more than 1.2 million dekatherms per day of peak-day and upstream transportation and storage capacity on nine interstate natural gas pipelines.⁶ Through a subsidiary, Piedmont also owns a 35 percent equity interest in Pine Needle LNG Company, L.L.C., a FERC regulated LNG facility. Through another subsidiary, Piedmont is an equity participant in SouthStar Energy Services, L.L.C., a retail energy marketing company operating in the southeastern United States. Piedmont itself is an active participant in the secondary market for interstate natural gas

⁶In North and South Carolina, however, Piedmont is directly connected to only one interstate pipeline: the Williams-Transco system.

pipeline capacity and regularly engages (as both buyer and seller) in secondary commodity sales and capacity release transactions.

Because of its wide ranging participation in the interstate natural gas market, Piedmont has focused on the NOPR/NOI from the perspective of both a buyer and seller of interstate capacity and in formulating these comments has attempted to take into account the interests of all industry segments, particularly residential and small commercial consumers, and the changing nature of LDC merchant service obligations.

II. INDUSTRY DIALOGUE

The Commission's NOPR and NOI have prompted extensive discussions among (and within) various industry segments regarding the manner in which the primary and secondary interstate natural gas markets should be regulated in the future. These groups have included both segment specific groups such as the AGA FERC Regulatory Committee as well as industry wide groups such as the Natural Gas Council dialogue group.⁷ Each segment and each company within the industry has their own concerns and specific issues relating to the potential restructuring of the interstate natural gas markets. Piedmont and UGI are pleased to report to the Commission that the discussions among the industry participants during the last four months have been full and frank. These discussions have contributed to a better and more informed understanding of the dynamics in the marketplace (from wellhead to burner-tip) and the concerns and suggestions for improvements raised by various companies and groups.

⁷Piedmont and UGI have actively participated in both these groups as well as related industry proceedings and in many informal discussions of possible restructuring with other industry participants.

As a result, the quality of the comments filed with the Commission should be vastly improved.⁸

Although no agreement or consensus was reached by the Natural Gas Council dialogue group concerning the issues raised by the NOPR and NOI, the participants early in the discussions identified six primary goals for the industry. These are:

- (1) All segments of the industry benefit if all segments are financially healthy;
- (2) All segments of the industry should work together to grow the natural gas market;
- (3) Reliability of service is a crucial element to the health of the industry;
- (4) A simpler, less complex market and regulatory structure would be beneficial to the industry;
- (5) The industry needs to maintain a long-term perspective and focus on long-term issues; and
- (6) The industry needs to focus on removing barriers to developing resources (supply, infrastructure, and markets).

It was in this context that the participants discussed the marketplace, regulatory options, issues and concerns. While, as stated above, no consensus has yet been reached, general themes have developed.

Some participants advocated the need to create a more light-handed regulatory structure that permits greater flexibility in offering products and services in a competitive marketplace (e.g., enhanced rate-making flexibility, seasonal or term differentiated rates and negotiated terms and conditions). Other participants cautioned against the potential abuse of market power and discrimination that could occur in markets where workable competition

⁸The extension granted by the Commission to the original comment deadline in order to permit these discussions to occur has proven to be extremely valuable. In fact, the Natural Gas Council dialogue group agreed at its last meeting on March 4 to reconvene following the April 22 comment date to pursue further discussions.

does not exist (e.g., the need for high quality recourse service that cannot be degraded, rate caps, rights of first refusal, and affiliate preference protections). Some participants urged the need for additional incentives for pipelines to reduce costs and rates, improve efficiencies and avoid protracted regulatory proceedings (e.g., departure from SFV rate design, a review of pipeline capital structures and ROEs, and the adoption of incentive rate mechanisms). Others maintained the need for greater value and flexibility in the hands of long-term FT capacity holders while maintaining reliability of service (e.g., a deregulated secondary capacity release market, more comparability between primary and secondary services and penalties that deter shipper abuses of imbalances and overruns).

As to a few specific issues, all participants (other than the producing segment) strongly opposed the adoption of the mandatory auction for short-term capacity proposed by the Commission in the NOPR. Further, no participants suggested that the Commission re-regulate the secondary commodity sales market and no participants (other than the industrial group and perhaps some producers) opposed the deregulation of the secondary capacity release market. Finally, no participants suggested a departure from cost-based rates for primary pipeline recourse service under long-term contracts. Piedmont and UGI's comments and suggested framework below attempt to build on the areas of general agreement while taking into account and balancing the competing themes and concerns expressed by the parties.

III. THE INTERSTATE NATURAL GAS TRANSPORTATION MARKETS

A. The Primary Market

The primary natural gas transportation capacity market can be divided into long-term pipeline firm transportation service arrangements of a year or longer and short-term firm and interruptible services. Long-term arrangements in the primary market are generally characterized by firm service agreements held primarily by LDCs under which cost-based

straight fixed variable ("SFV") rates⁹ are paid for high quality recourse service. Firm long-term contract holders receiving Part 284 NGPA service have the ability to protect their capacity upon the expiration of their contracts under the Commission's five year matching term right of first refusal policy. Part 157 shippers have comparable abandonment protection under the Commission's NGA regulations. In the long-term primary capacity market, available pipeline capacity is distributed through mechanisms that generally ensure the non-discriminatory allocation of such capacity. While uniform terms and conditions and maximum rates for FT service are established by tariff, pipelines have substantial pricing flexibility by engaging in discounted¹⁰ and/or negotiated¹¹ rate transactions. In other words, pipeline capacity in the primary market has already been price deregulated with the mutual consent of the pipeline and individual shippers. Pipelines also have the ability to seek Commission approval to offer any type or variety of tariff service they desire so long as it is offered on a generally available basis.

The short-term primary capacity market is characterized by firm pipeline services with maximum rates equivalent to long-term cost-based recourse rates and interruptible rates generally calculated at the 100 percent load factor equivalent. Just like long-term primary

⁹A group of LDCs filed comments on February 1, 1999 in this docket in which they proposed and supported a mandatory move away from SFV rates for interstate pipelines. Although Piedmont and UGI were not parties to those comments, it agrees with the proposal and reasoning of the Customer Coalition regarding SFV rates and fully supports that proposal.

¹⁰Pipelines currently have the ability to enter into discount arrangements below maximum rates to meet competition.

¹¹Pipelines also have the ability to enter into negotiated rate transactions above maximum rates. *Statement of Policy and Request for Comments* in Docket Nos. RM96-6-000, *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines*; and RM96-7-000, *Regulation of Negotiated Transportation Services of Natural Gas Pipelines*, 74 FERC ¶ 61,067 (1996).

service, uniform terms and conditions of service are established by tariff, and price deregulation flexibility is provided through the ability of pipelines to negotiate above and discount below the maximum tariff rates with the mutual consent of individual shippers.

B. The Secondary Market

The secondary capacity market consists of two distinct types of transactions. The first are deregulated rebundled commodity sales transactions combining natural gas with interstate transportation capacity rights. The second are highly regulated capacity release transactions engaged in by shippers and other entities holding primary firm transportation capacity rights on interstate pipelines.

Section 284.402 of the Commission's Regulations grants blanket certificate authority to any person other than an interstate natural gas pipeline to make unregulated sales for resale of natural gas on negotiated terms and conditions. Shippers and marketers utilize this authority to make unregulated rebundled commodity sales of natural gas on a regular basis at numerous points on the interstate pipeline grid including market centers, pooling points, market hubs, city gates and the burner tip. A highly competitive commodity "basis" sales market has developed where commodity sales transactions are negotiated and executed on a daily and monthly basis.¹² These transactions are individually negotiated and tailored (under private contracts) to meet the needs and desires of the contracting parties.¹³ The terms of

¹²The existence and dynamic nature of the secondary commodity sales market is a testament to just how much the short-term secondary market has changed since the implementation of Order 636. Numerous industry trade publications (examples of which include *Inside FERC*, *Gas Daily*, *Natural Gas Week*, *Natural Gas Intelligence*, etc.) post daily and monthly prices for commodity sales at various points on the interstate pipeline grid.

¹³In fact, many LDCs, including Piedmont and UGI, rely on city gate commodity sales service from third-party suppliers to meet the peak day requirements of their core high priority customers.

the transactions which are typically negotiated include term of service (day, month or year), quality of service (firm, recallable or interruptible), quantity of service (baseload or swing), nature of service (peaking, annual or seasonal), and price of service (two part or volumetric). This commodity sales market is highly competitive, extremely flexible and unencumbered by significant regulatory restrictions.

Capacity release transactions, on the other hand, are subject to substantial and extensive regulation by the Commission. This regulation includes significant posting, bidding and reporting requirements for available capacity, as well as price ceilings tied to individual pipeline rates. Under current Commission regulations, shippers that desire to release capacity must post the availability of that capacity on the electronic bulletin board maintained by the pipeline on which the capacity is held. That posting is then subject to a multiple step competitive bidding and confirmation process which is relatively slow and unresponsive. This process generally must be followed except where the releasing party already has negotiated a prearranged transaction for the capacity at maximum rates or for a term of one month or less. Terms and conditions of service for the released capacity, as well as the price at which the capacity is releasable, are all restricted by the pipeline tariff. As such, and unlike deregulated commodity sales and primary pipeline capacity, parties to capacity release transactions have no ability to negotiate a price above the maximum pipeline recourse rate. While the Commission's current approach to capacity release regulation has the benefit of transparency, these transactions are substantially more cumbersome and less flexible than those that can be accomplished through either deregulated commodity sales transactions or primary pipeline capacity transactions.

A graphic representation of the current interstate capacity markets, illustrating the primary regulatory attributes of each, is set out below:

INTERSTATE CAPACITY PRICING MODEL -- CURRENT MARKETS

CURRENT MARKET	Primary Service	Secondary Service	
		Commodity Sales	Capacity Release
Short Term	Cost based SFV recourse rates Price flexibility through discounted and negotiated rates (deregulated with mutual consent of the pipeline and shipper)	Deregulated	Cost based SFV recourse rates Limited price flexibility through discounting No ability to exceed maximum rate cap
Long Term	Cost based SFV recourse rates Price flexibility through discounted and negotiated rates (deregulated with mutual consent of the pipeline and shipper)	Deregulated	Cost based SFV recourse rates Limited price flexibility through discounting No ability to exceed maximum rate cap

C. Problems With and the Interrelated Nature of the Existing Capacity Markets

The current regulation and operation of the primary and secondary markets is problematic for many sectors of the industry. These problems arise, in part, from the relationship between the short and long-term markets¹⁴ and include a fundamental misalignment in the relative risks and costs of subscribing to long-term primary capacity in

¹⁴As most participants to the ongoing dialogue prompted by the NOPR and NOI have recognized, the primary and secondary markets for interstate natural gas transportation services are inextricably linked. Measures taken to restructure service in one market will inevitably impact the value and characteristics of service in the other.

comparison to short-term capacity as well as substantial risks to shippers and pipelines arising from certain aspects of the operation of the primary and secondary markets.

Shippers holding long-term firm primary capacity rights on interstate pipelines currently pay -- under SFV rates -- a premium price for service that exposes the shipper to a significant degree of risk. In contrast, short-term services are much less risky and are relatively inexpensive by comparison. These price/risk relationships -- high prices for high risk service and low prices for low risk service -- are exactly opposite of what they should be in a rational market and create significant problems for participants in the interstate natural gas transportation markets.

Long-term primary capacity arrangements under SFV rates are subject to a significant degree of risk through the allocation of all pipeline fixed costs to shippers who subscribe to firm peak-day capacity and requiring payment of those costs in demand charges. These long-term firm contracts are extremely expensive and risky when compared to short-term firm and interruptible services. When the changing nature of LDC merchant services under various state unbundling programs is considered, the risks of long-term SFV contracts become even more apparent. Finally, the potential for significant capacity turnback on pipelines (especially those serving areas with excess capacity) magnifies the risks of long-term SFV rates. As a result of these risks, many shippers are reluctant to subscribe to new or rollover long-term capacity. Many pipelines are beginning to experience that reluctance through their inability to obtain long-term maximum rate service agreements.

Problems with the current regulation of the short-term market add to the risks of holding long-term capacity. For example, in periods of low demand and excess capacity, market pressures drive the prices of secondary released capacity, commodity sales and short-term primary pipeline service down to discounted levels. As a result, existing subscribers to

long-term firm capacity are unable to recover significant value from their offpeak entitlements. And while this "market" driven behavior would be expected and desirable in a deregulated market, that is not the context in which these transactions take place because, during peak periods, pipelines have no ability to access market prices above existing maximum rates for short-term primary capacity (without a shipper's consent) and shippers cannot release capacity above existing maximum tariff rates under the Commission's current regulations. This lack of symmetry in the pricing flexibility of short-term services creates risk for both pipelines and firm capacity holders and devalues both short-term and long-term capacity.

In order to cure these problems and create an interstate natural gas transportation market which is more competitive and market based -- which is the Commission's stated goal in these proceedings -- this misalignment between the costs and risks of long and short-term services must be corrected. In doing so, however, the potential problem of market power abuse must also be addressed, particularly as it relates to captive customers and areas where workable competition does not exist in the primary market.

IV. THE COMMISSION'S NOPR AND NOI

A. Notice of Proposed Rulemaking And Notice of Inquiry

On July 29, 1998, the Commission issued its *Notice of Proposed Rulemaking* in Docket No. RM98-10-000, the purpose of which was to address the evolving nature of the short-term market for interstate natural gas services. The mechanisms proposed by the Commission for the future regulation of this market would effectively deregulate pricing for primary short-term and capacity release transactions subject to an all encompassing mandatory auction process.¹⁵ This auction process would require all pipeline primary capacity

¹⁵In the NOPR, FERC asked a multitude of questions regarding the possible restructuring of the primary short-term and capacity release markets. These questions, among others,

to be sold on a daily basis with no reserve price. In effect, under the Commission's NOPR, all short-term capacity would become subject to substantial posting and bidding requirements which would be both administratively complex and expensive to implement.

Also on July 29, 1998, the Commission issued a *Notice of Inquiry* in Docket No. RM98-12-000, in which it sought input on many issues related to the future structure of the primary long-term natural gas transportation market.¹⁶ The *Notice of Inquiry* recognized that inefficiencies and problems present in the short-term market were reflected in the long-term market as well.

A graphic representation of the interstate capacity market structure proposed by FERC in the NOPR is as follows:

included (1) whether price caps and posting and bidding requirements for capacity release transactions inhibited transportation during periods of peak demand; (2) what should be the definition of "short term" for purposes of FERC's examination of the short-term market; (3) what is the best mechanism to guard against the exercise of market power by pipelines (and others) in the short-term market; (4) whether FERC's mandatory auction proposal was the best way to accomplish restructuring in the capacity release and primary short-term markets; (5) whether FERC's proposal to revise nomination and confirmation procedures and to require increased reporting was desirable; (6) whether pipeline penalty procedures should be revised; (7) whether pipelines should be allowed to negotiate their terms and conditions of service; and (8) whether the five year matching term cap for rights of first refusal should be eliminated.

¹⁶The questions asked by the Commission in this proceeding included (1) whether the Commission should abandon the SFV rate design; (2) what test should the Commission use to evaluate market need for new projects; (3) whether the Commission should apply different standards in evaluating new projects where subscribers include pipeline affiliates; (4) how to address concerns over possible overbuilding and capacity turnback; and (5) whether the Commission should distinguish between projects serving existing markets versus projects that would develop new markets in its evaluation of certificate proceedings.

INTERSTATE CAPACITY PRICING MODEL -- FERC PROPOSAL

FERC Proposal	Primary Service	Secondary Service	
		Commodity Sales	Capacity Release
Short Term	Deregulated (with auction and no daily reserve pricing)	Deregulated	Deregulated (with auction and reserve pricing)
Long Term	Cost based recourse rates Price flexibility through discounted and negotiated rates (deregulated with mutual consent of the pipeline and shipper)	Deregulated	Cost based recourse rates Limited price flexibility through discounting No ability to exceed maximum rate cap

Piedmont and UGI understand that the AGA will file comments in both RM98-10 and RM98-12 to address concerns and questions regarding the Commission's proposal. Except as otherwise addressed by Piedmont and UGI's proposal, Piedmont and UGI, are members of AGA, adopt and incorporate by reference herein the initial comments of the AGA in these proceedings as well as the proposal of the Customer Coalition to eliminate SFV rate design on interstate natural gas pipelines.

B. The Problems With FERC's Proposal

Piedmont and UGI believe that there are several troublesome aspects of the Commission's proposal which bear comment.¹⁷ These relate primarily to the FERC's proposal to (1) implement a mandatory auction process for all short-term capacity transactions, (2)

¹⁷As stated above, Piedmont and UGI's position on issues not directly addressed in these comments, such as the Commission's NGPA Part 284 right of first refusal regulations, are consistent with those of the AGA as set forth in its comments in this proceedings.

deregulate all primary pipeline short-term capacity, both firm and interruptible and (3) eliminate pipeline reserve pricing practices for daily capacity.

The mandatory auction process proposed by the Commission, although attempting to establish a capacity clearinghouse for market transparency, does nothing to curb pipeline market power or create workable competition in the short-term primary market. In markets where pipeline capacity is constrained, the deregulation of primary pipeline capacity may, notwithstanding the auction, force shippers to pay monopoly prices to pipelines in order to secure short-term firm or interruptible capacity necessary to meet consumer demand requirements. This may occur not only in markets served by a single interstate pipeline, but also in markets where multiple pipelines exist and total daily capacity to the market does not comfortably exceed total seasonal and peak day requirements. The mandatory auction does not create capacity to establish workable competition in such markets, but merely institutes a mechanism to identify and confirm the existence of market power. This provides little comfort to shippers who, for whatever reason, may need short-term firm or interruptible pipeline capacity during periods of peak demand.

With or without a mandatory auction, Piedmont and UGI are opposed to any suggestion that primary recourse pipeline services (short or long-term) can be deregulated without a specific pipeline-by-pipeline showing of workable competition. This is because of the inherent operational and informational advantages pipelines have in controlling the availability of capacity to the marketplace.¹⁸ These operational advantages include (1) the substantial physical flexibility of pipelines (using line pack, storage, compression and other assets) to

¹⁸See March 11, 1999 *Comments of Piedmont Natural Gas Company, Inc. and North Carolina Natural Gas Company* in Docket No. PL99-1-000 and *Comments of Piedmont Natural Gas Company, Inc., North Carolina Natural Gas Corporation and Public Service Company of North Carolina, Inc.* in Docket No. RM96-14-000.

exceed the sum of shipper firm capacity entitlements, (2) a pipeline's use of retained system storage, Part 157 contract capacity and other assets to "create" short-term operating capacity that is not otherwise releasable by firm Part 284 capacity holders, and (3) substantial displacement and backhaul capabilities by the pipeline that are not available to firm capacity holders because of Commission imposed restrictions that preclude the simultaneous release of forward haul and backhaul/displacement rights by shippers in excess of firm contract demand levels. As a result, while pipeline primary services are always available as a competitive alternative to secondary services; the reverse is not true. When firm capacity holders are utilizing all of their firm entitlements during a period of peak demand, primary pipeline capacity may be the only short-term service available to the market. Coincidentally, this is the precise moment when pipelines have the greatest incentive and opportunity to abuse their market power.¹⁹ In light of the foregoing, Piedmont and UGI strongly submit that deregulation of primary pipeline capacity (both firm and interruptible) on a generic basis would be ill-advised without a specific pipeline-by-pipeline showing of workable competition.

Another problem with the mandatory auction proposal relates to the elimination of pipeline reserve pricing for daily capacity. This requirement will force daily capacity values on interstate pipelines down to variable costs during offpeak periods when capacity exceeds demand. Not only will short-term offpeak capacity be "worthless," long-term firm capacity will also be devalued placing additional risks on existing firm capacity holders and disincentives for new shippers to subscribe to long-term firm contracts. Because of the collapse of offpeak capacity values, interstate pipelines will be forced to find ways to increase

¹⁹Moreover, pipelines have perfect and real-time knowledge of all transactions on their systems as well as all capacity constraints. The availability of this information gives pipelines an enormous and unfair market advantage.

peak period prices to captive high priority markets through the exercise of market power to recover their offpeak losses. Further, the elimination of reserve pricing coupled with deregulation of the short-term primary market will establish "lower lows" and "higher highs" for capacity values and create even more market volatility and destabilization.

Finally, the design and implementation of a single integrated auction mechanism to accommodate the complexities and interdependencies inherent in daily and monthly secondary and primary short-term capacity transactions across the U.S. pipeline grid is fraught with overwhelming difficulties. First, implementation of any such mandatory auction process would perpetuate and expand upon many of the infirmities and inefficiencies currently afflicting the capacity release market. Second, to the extent this mechanism is forced on parties that desire to engage in private negotiations and prearranged contracts for secondary capacity, it would seriously disrupt existing and smoothly functioning mechanisms for allocating secondary capacity. Third, the administrative difficulties inherent in designing and implementing an effective short-term capacity auction mechanism consistent with the realities of gas supply negotiations, pipeline nomination requirements and intra-day renomination flexibility may be literally impossible to overcome. Finally, and as was apparent from the comments of many parties at the technical conference on this subject, there is substantial doubt that a universal auction process can be implemented fairly and efficiently and grave concerns remain about the ramifications of failure, particularly in light of the significant direct and indirect costs that would be incurred to develop and implement the necessary systems.

For the foregoing reasons, Piedmont and UGI respectfully request that the Commission abandon its mandatory auction proposal set forth in the NOPR in favor of a simpler, more workable solution to the problems existing in the primary and secondary capacity markets, as set forth below.

V. PIEDMONT AND UGI'S PROPOSED FRAMEWORK FOR INTERSTATE CAPACITY MARKETS

Piedmont and UGI set forth the following proposals for restructuring the primary and secondary interstate natural gas capacity markets in order to promote more effective competition in those markets while preventing market power abuse. The specific measures that make up Piedmont and UGI's proposal are as follows:

- (1) Preservation of high quality cost-based long-term pipeline recourse service subject to a mandatory departure from SFV rate design;
- (2) Increased pipeline flexibility to negotiate terms and conditions of service with appropriate safeguards;
- (3) Optional pricing flexibility for (but not deregulation of) primary pipeline short-term services combined with implementation of a revenue crediting mechanism; and
- (4) Deregulation of secondary capacity release transactions.

Each of Piedmont and UGI's suggestions for restructuring the primary and secondary interstate capacity markets is discussed below and are graphically represented as follows:

INTERSTATE CAPACITY PRICING MODEL -- PIEDMONT AND UGI'S PROPOSAL

Piedmont and UGI'S Proposal	Primary Service	Secondary Service	
Short Term	Cost based non SFV "flex" recourse rates Price flexibility through discounted and negotiated rates (deregulated with mutual consent of the pipeline and shipper)	Commodity Sales	Capacity Release
		Deregulated	Deregulated
Long Term	Cost based non SFV recourse rates Price flexibility through discounted and negotiated rates (deregulated with mutual consent of the pipeline and shipper)	Deregulated	Deregulated

A. Long-Term Primary Capacity

Piedmont and UGI believe that the foundation of long-term primary capacity arrangements on interstate pipelines must continue to be high quality firm recourse service at cost-based rates. This structure for long-term service helps guard against pipeline market power and generally has served the industry well. As previously noted, Piedmont and UGI believe that long-term recourse rates should not be based on an SFV rate design because of the risks to shippers and the impediments to a competitive market which SFV rates create.²⁰

²⁰As noted above, Piedmont and UGI support the Customer Coalition filing on the elimination of SFV rates. The benefits that would accrue from the elimination of SFV rates (as described in the Customer Coalition filing) include: (a) reduction in risk to long-term

Pipelines should continue to have pricing flexibility through the ability to discount and negotiate long-term rates. In addition to this price flexibility, Piedmont and UGI are not opposed to the added ability of interstate natural gas pipelines to negotiate terms and conditions of service with customers if appropriate safeguards (as described in the AGA comments) are adopted. As is the case with the Commission's current negotiated rate policy, any risks associated with negotiated terms and conditions of service should be allocated to the pipeline (or the individual shipper agreeing to such terms) and should not detrimentally impact service to other shippers. This means that any negotiated terms and conditions with individual shippers must not result in cost-shifting to recourse shippers, subsidies for new services or shippers, degradation of existing recourse service, or unfair preferences for negotiating shippers or pipeline market affiliates. To implement negotiated terms and conditions flexibility, the Commission should promulgate a generic Negotiated Terms and Conditions Policy with individual pipeline implementation proceedings.²¹

In sum, other than a change away from SFV rates, Piedmont and UGI do not believe that there is anything substantially wrong with the Commission's current regulation of long-term pipeline primary service and that the quality and reliability of long-term firm capacity as a cost-based recourse service must be maintained for the benefit of all participants in the industry.

contract holders; (b) reduction in the current bias favoring short-term contracts; (c) creation of incentives for pipelines to maximize throughput; (d) protection of shippers as new rate and service flexibilities for natural gas pipelines are implemented; (e) reduction in risk associated with construction of new pipeline projects; (f) reduction in the number of OFOs issued; and (g) reduction of potential stranded costs from retail unbundling.

²¹In these individual pipeline proceedings it will be necessary to define the existing high quality recourse service on each pipeline in order to provide a benchmark against which to measure the impact of negotiated terms and conditions on recourse shippers.

B. Short-term Primary Capacity

Piedmont and UGI propose that the Commission authorize (but not require) pipelines to increase the cost-based maximum recourse rates for IT and short-term firm service. Specifically, pipelines should be permitted -- at their option and pursuant to a limited Section 4 filing -- to "flex up" their maximum recourse rates for short-term services to twice their existing levels in order to correct the misalignment in short and long-term primary service pricing discussed previously. The purpose of these "flex" rates is to allow pipelines to increase pricing for short-term services but to keep those prices capped at some reasonable level to guard against pipeline market power. The exact level of the increase in maximum rates is a matter of judgment but Piedmont and UGI believe that a doubling of existing rates is reasonable. Several facts support Piedmont and UGI's belief in this regard. First, based on Piedmont and UGI's understanding, a doubling of the existing maximum tariff rates for pipeline short-term services would allow significant pipeline pricing flexibility but would still cap rates at a level below the highest prices Piedmont and UGI have observed for commodity sales transactions on the pipelines on which Piedmont and UGI do business. Second, by allowing a flex up rate equivalent to a doubling of maximum tariff rates, pipelines gain the flexibility to price services from their minimum variable cost (near zero) to 200 percent of the 100 percent load factor rate for those services. These "flex" rates for short-term services, when combined with existing discounting and negotiated rate capabilities, would provide interstate pipelines with substantial pricing flexibility while avoiding the necessity of examining pipeline market power or workable competition in the primary market.

In order to protect against the risk of significant over-recovery, while simultaneously providing pipelines with an incentive to maximize the availability of short-term services, Piedmont and UGI also propose that pipelines credit to their customers 75 percent of any

annual revenues collected by the pipeline from short-term services in excess of the annual level imputed for such services in the pipeline's last approved general Section 4 rate case.²²

Piedmont and UGI propose that pipelines that desire to implement "flex" rates for short-term firm and interruptible services be required to make a limited Section 4 filing with the Commission. The purpose of this filing would be solely to flex short-term service rates up to twice their existing level, establish a crediting mechanism and to identify the level of imputed revenues for pipeline short-term services from the pipeline's last Section 4 general rate case. No cost of service, throughput or cost allocation issues would be examined in these proceedings

Piedmont and UGI's short-term "flex" recourse rate proposal has numerous advantages. First, it significantly increases existing pipeline pricing flexibility for short-term services. Second, it provides pipelines with an incentive to maximize short-term services for the benefit of all system shippers and the pipeline. Third, it promotes competitive and more market-based pricing in the short-term market. Fourth, it provides protection against pipeline market power abuse by retaining price caps (albeit at higher levels). Fifth, it increases the value of long-term capacity by protecting such capacity from being improperly undercut by pipeline short-term services that are artificially capped at rates below market levels. Sixth, it will assist in the reformation of short-term service pricing by allowing those prices to rise towards the

²²This mechanism would be similar in nature to the IT revenue crediting mechanism implemented by FERC as an interim measure following Order 636. Like that mechanism, this one could be an intermediate step designed to facilitate Commission policies while guarding against pipeline over-recoveries.

market level in periods of peak demand.²³ Finally, this approach is incremental in nature and is easily implemented across the interstate pipeline grid system.

C. Secondary Released Capacity

In order to eliminate the bias in favor of rebundled commodity sales in the secondary market, the Commission should deregulate secondary capacity release transactions. This deregulation should include, at a minimum, the following elements:

1. The elimination of price ceilings. In order to facilitate market-based pricing, maximize the value of long-term capacity, and permit secondary capacity release to compete on a comparable basis with commodity sales transactions, the Commission should eliminate maximum rate caps on capacity release.

2. The elimination of mandatory posting and bidding requirements. The Commission should eliminate mandatory posting and bidding requirements for capacity release transactions. This would provide shippers with flexibility to negotiate prearranged bilateral transactions for interstate capacity on terms dictated by the market.²⁴ In order to accommodate those parties who find the posting and bidding mechanism useful, the availability of the current mechanisms should be maintained for use on an optional basis.

²³Earlier in their comments, Piedmont and UGI noted that long-term primary service is over-priced in comparison to short-term primary service when the relative risks of the two types of service are considered. The Commission itself has observed the need for peak pricing flexibility in the short-term market in order to allow prices to rise to their appropriate market levels. Permitting pipelines to charge up to twice the maximum tariff rates for short-term services will help realign short-term market pricing to appropriate levels.

²⁴Under many retail unbundling programs in place today or being considered by state commissions, the ability of LDCs to assign their upstream interstate capacity to third-party retail marketers is critical. Such assignments are intended to minimize stranded costs to consumers, minimize the redundant duplication of citygate services and facilities and to preserve the reliability of interstate capacity used to serve core customers on peak days in geographic areas where pipeline capacity is constrained.

3. The elimination of "The Shipper Must Have Title" Rule for both Part 284 and Part 157 service. Elimination of the "shipper must have title" rule will enhance the deregulated secondary market by providing increased market choices to shippers and end users. Further, LDCs engaged in or contemplating unbundling are seeking waivers of the Commission's "shipper must have title" rule in order to grant retail marketers operating behind LDC citygates access to interstate capacity services which are not otherwise releasable. The Commission should eliminate this rule in order to further facilitate unbundling at the state level.

The Commission can deregulate the secondary capacity release market with confidence that there will be no adverse market consequences because capacity release transactions are subject to keen competition from other shippers seeking to release capacity, from deregulated commodity sales service, as well as from pipeline short-term firm and IT service, which under Piedmont and UGI's proposal would be capped at maximum recourse "flex" rates. The secondary market is already effectively deregulated by virtue of the existence of a vigorous and competitive commodity sales market. Because capacity release transactions are already subject to market based competition, the risk of deregulating capacity release transactions to make them comparable to commodity sales is negligible.

Piedmont and UGI recognize that some industry participants may have concerns over the deregulation of secondary capacity release pricing relating to potential shipper market power. The following factors provide a high degree of comfort, however, that market power could not be effectively exerted by shippers in the secondary market. First, as explained above, shippers utilizing capacity release transactions will be subject to substantial

competition from numerous sources of capacity in both the primary and secondary markets.²⁵ Second, a continuation of after the fact reporting of capacity release transactions on pipeline EBBs (as is currently done) could provide market transparency following deregulation.²⁶ Third, if a shipper were exercising (or was alleged to be exercising) market power in an anti-competitive fashion, the Commission's revised complaint procedures would be available to address the situation. Given these factors, the likelihood of actual shipper market power abuse would appear to be *de minimis*.

²⁵An additional way in which the Commission could foster even more robust competition in the gas transportation market would be to allow firm capacity holders "tertiary rights" on pipelines. This mechanism would permit firm contract holders to nominate (up to their firm capacity entitlements) tertiary capacity between any two points on a pipeline for which the firm contract holder does not have primary or secondary nomination rights. Tertiary capacity would have a higher priority than pipeline IT but a lower priority than primary and secondary firm capacity. Tertiary nomination rights, once confirmed, would be subject to pro rata curtailment.

Shippers using tertiary rights would compete with all other shippers on a pipeline, and very importantly, with the pipeline itself in areas of a pipeline where existing contract holders need their primary capacity. This would prove to be a very powerful check on market power up and down the whole pipeline. And similar to pipeline short-term services, but unlike secondary firm rights on many pipelines, tertiary transactions could be scheduled across zone boundaries. Currently, some pipelines prohibit linking secondary rights across zones while simultaneously allowing IT to be nominated between any two points on the pipeline.

Backhaul transactions could also be used to create efficiencies and provide additional competition in the primary and secondary market. Under current FERC policy, FT contract holders are restricted from exceeding their MDQ through any segment of the pipeline whether such capacity is used for forward haul or backhaul transactions. This policy fails to take into account the operational flexibility provided by backhaul transactions. Subject to the operational integrity of the pipeline, firm shippers should be permitted to effect backhaul transactions up to their full MDQ rights irrespective of any simultaneous forward haul transactions. In this way, firm shippers would enjoy operational flexibility more comparable to that utilized by pipelines in marketing primary services.

²⁶Piedmont and UGI do not object to after-the-fact reporting of capacity release transactions in order to provide market transparency. Such reporting should demonstrate to the Commission and market participants that no shipper market abuses are occurring.

In sum, the Commission should strip away the regulatory impediments that prevent secondary capacity release transactions from being fully competitive with commodity sales transactions. This action will promote competition and economic efficiency in the secondary market and, in light of the substantial competition that exists in that market already, can be safely undertaken without fear of any adverse consequences.

D. Benefits of The Proposed Approach

There are numerous and substantial benefits that would flow to the natural gas industry as a whole from implementing Piedmont and UGI's proposal to complete the deregulation of the secondary market and to provide more flexible regulation of the primary market.

1. Benefits of a Deregulated Secondary Market

Among the benefits that would accrue from a deregulated secondary market are the following:

- a. The tailoring of competitive supply and capacity services to meet the firm and interruptible needs of all classes of customers.
- b. The efficient utilization of pipeline capacity at higher load factors.
- c. Increased market liquidity which will further facilitate the over-the-counter market for trading and risk management arrangements.
- d. A viable secondary market which will allow firm shippers to mitigate risks associated with long-term contracts, retail unbundling and stranded costs.
- e. Increased value (decreased risk) in longer term contracts needed to support new pipeline construction projects.
- f. Flexibility in interstate capacity assignment programs in accordance with state retail unbundling policies.
- g. A simpler, less complex and more efficient capacity release market which is of more use to the industry and on terms comparable to the deregulated commodity sales market.

- h. Appropriate price signals to interstate pipelines regarding the need for construction of new capacity or the existence of excess capacity.

2. Benefits of a Regulated but more Flexible Primary Market

The benefits that will derive from a more flexible primary market include:

- a. Greater pipeline flexibility to price short-term services in accordance with their market value but still subject to regulated cost of service based caps.
- b. No requirement to examine market power and competition issues.
- c. Preservation of existing pipeline tariff provisions regarding open season and NPV procedures and elimination of industry wide auction procedures will promote a simpler, less complex market which is more consistent with the realities of supply negotiations and pipeline nominations requirements.
- d. More flexible short-term rates along with long-term negotiated rates and service structures provide tools for pipelines to address capacity turnback risks.
- e. More efficient utilization of pipeline capacity at higher load factors reduces unit costs for the benefit of all industry segments and positions the gas industry to capture a greater share of US energy requirements.

CONCLUSION

Piedmont and UGI propose that the Commission adopt measures to fully deregulate the secondary market and provide more flexibility for pipeline services in the primary market. The specific mechanisms proposed by Piedmont and UGI to accomplish this task include:

- (1) Preservation of high quality cost-based long-term pipeline recourse service subject to a mandatory departure from SFV rate design;
- (2) Increased pipeline flexibility to negotiate terms and conditions of service with appropriate safeguards;
- (3) Optional pricing flexibility for (but not deregulation of) primary pipeline short-term services combined with implementation of a revenue crediting mechanism; and

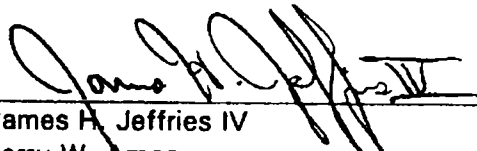
(4) Deregulation of secondary capacity release transactions.

Adoption of these regulatory mechanisms will ensure that the future markets for interstate pipeline capacity are efficient, dynamic, market based, and free of the potential for market power abuse.

WHEREFORE, Piedmont Natural Gas Company, Inc and UGI Utilities, Inc. respectfully request that the Commission accept and consider their initial comments and proposed framework as set forth above.

Respectfully submitted, this the 21st day of April, 1999.

**Piedmont Natural Gas Company, Inc. and
UGI Utilities, Inc.**



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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing document was served
upon each person designated on the official service list compiled by the Secretary in this
proceeding by depositing a copy of the same in the United States Mail, First Class Postage
Prepaid, to their last known address.

Dated at Greensboro, North Carolina, this the 21st day of April, 1999.



Sonya R. Lowe